

# EXPLORING MICHIGAN TAXES

House Tax Policy  
Committee

February 18, 2009

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## Overview

- Taxes Michigan Citizens Pay
- Features of Major Taxes
- Constitutional Restrictions
- Comparative Tax Burdens
- The Treasury website.

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## Taxes Michigan Citizens Pay

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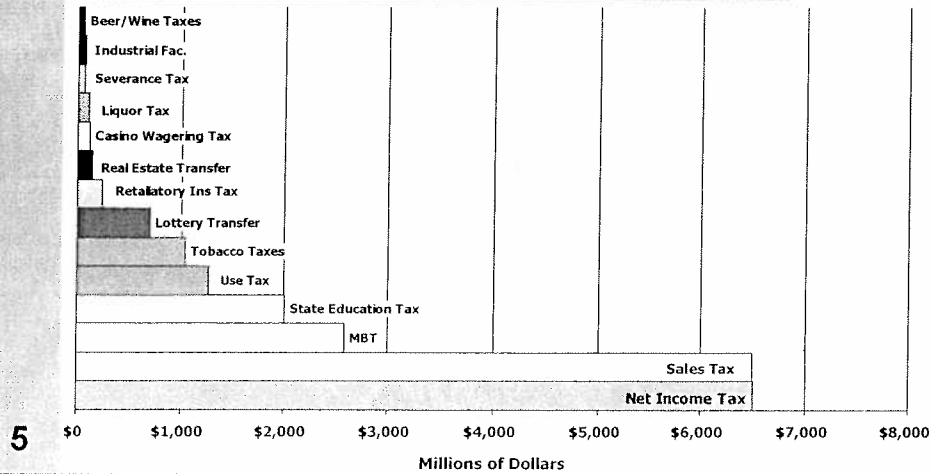
## Total State and Local Taxes

	FY 2006 Amount (millions)	Percent of Total
State Property Taxes	\$2,240.3	6.2%
State Income taxes	\$6,226.3	17.3%
State Sales & Use Taxes	\$8,080.9	22.4%
State Business Taxes	\$1,886.2	5.2%
Motor Fuel Taxes	\$1,061.7	2.9%
Other State Taxes	\$4,219.1	11.7%
Local Property Taxes	\$11,284.7	31.3%
Local Income Taxes	\$472.6	1.3%
Other Local Taxes	\$545.1	1.5%
Total S&L Taxes	\$36,016.9	100.0%

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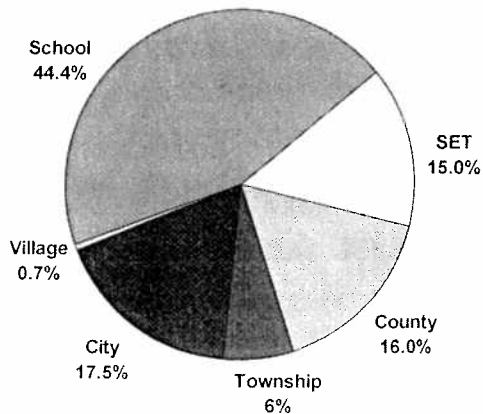
Source: Census data for FY 2006

## Michigan's Major State Taxes



## State and Local Property Taxes

CY 2007 Ad Valorem Property Taxes Total \$14.3 Billion



## Features of the Major Taxes

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### Personal Income Tax

- Flat rate tax at rate of 4.35%.
- Begins with federal adjusted gross income so most federal deductions do not flow through.
- Personal exemption of \$3500 with double exemption for seniors and disabled.
- Social Security and military pay exempt.
- Homestead property tax credit for taxes exceeding 3.5% of household income provides over \$800 million in relief.

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## Personal Income Tax

- Tax rate reduced from 4.6% to 4.4% in 1994 (Proposal A).
- Tax rate fell from 4.4% to 3.9% from 2000 through to 2005 and was raised to 4.35% in October 2007.
- Increase begins to phase out October 2011.
- Will raise \$6.5 billion in FY2009.
- 41 states have personal income tax; only 7 are flat rate.

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## Most Retirement Income Not Subject to Michigan Income Tax

- Up to \$43,440 (\$86,880 joint) in private retirement.
- All public retirement benefits are exempt.
- Retirement benefits include:
  - IRAs;
  - Traditional defined-benefit pensions;
  - Profit-sharing and other defined-contribution plans;
  - 401(k) and similar plans to the extent the benefits are due to employer contributions or mandatory employee contributions.
- Seniors may deduct up to \$9,690 (\$19,380 joint) in investment income, if they do not have other retirement income.

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## Sales Tax

- Imposed since 1933.
- 6% on sales of tangible property at retail.
- 73% to school aid fund; 16% to local government, 1% to transportation and 10% to general fund.
- 45 states have sales tax; median state rate is 5.5%; median state and local rate is 7.25%.
- Will raise \$6.5 billion in FY 2009.

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## Sales Tax – Major Exemptions

- **Status of purchaser-** e.g. government, non-profit, charitable or religious organizations.
- **Nature of property-** e.g. prescription drugs, food for immediate consumption; certain aircraft parts; air and water pollution control equipment.
- **Nature of use or status-** used in industrial processing operations, used in agricultural operations, purchased for resale.

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## Use Tax

- 6% tax on use or storage of tangible personal property and certain limited services.
- Compliment to sales tax-applies to items purchased from out of state; rental transactions, hotel rooms, items withdrawn from inventory, private auto sales.
- 1/3 to school aid fund, 2/3 to general fund - will raise \$1.3 million in FY 2009.
- Exemptions generally track sales tax.

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## Tobacco Taxes

- Cigarettes- \$2.00 per pack.
- Other tobacco products – 32% of wholesale price.
- Will raise \$1 billion in FY 09.
- Most recent increase to \$2.00 in July 2004.
- Additional revenues from tobacco settlement- \$290 million.

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## Property Tax

- 6 mills state education tax to school aid fund.
- 18 mills levied only on non-homestead property by local school districts forms local share of foundation allowance.
- Various rates by other units such as cities, counties, ISD's and community colleges.
- Property broadly divided between real (land and structures) and personal (machinery and equipment and other moveable property).

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## Property Tax Assessments

- Property cannot be assessed at more than 50% of true cash value.
- Taxable value cannot increase more than rate of inflation until property is transferred.
- Cap provides relief in times of rising prices;
- Persons with tenure in homes often see taxable value less than SEV.
- Assessment can increase in times of falling or steady prices if there is a remaining gap.

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## Common Property Tax Exemptions

- Government property.
- Nonprofit educational or charitable institution;
- Principle residence from 8 school operating mills.
- Principle residence because of poverty based on local standards.
- Renaissance zone property;
- Business property subject to abatement and alternative specific tax.
- 17 • Manufactured housing in licensed park.

## Michigan Business Tax

- New tax base of income and gross receipts less purchases of tangible personal property shifts part of burden to **ability to pay** (i.e. income) while maintaining a stable base.
- Substantial **personal property tax relief** addresses a major business concern.
- Tax credits provide incentives **to invest** in Michigan, **to employ** Michigan residents, and **to perform research and development** in the state.
- Special provisions **lower tax burden** for small businesses helping them to grow.
- 18 • SBT revenues **fully** replaced.

## New Tax Base

- **General Tax Base**

- Modified Gross Receipts, gross receipts minus purchases from other firms of capital and inventory, taxed at 0.8%.
- Business Income taxed at 4.95%.

- **Insurance Companies**

- 1.25% tax on direct premiums.

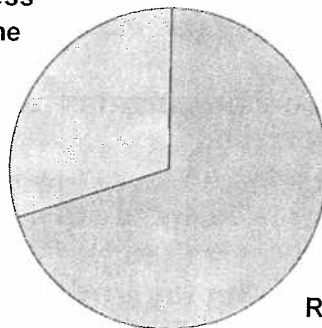
- **Financial Institutions**

- 0.235% franchise tax on net capital.

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## MBT Tax Base

Business  
Income  
30%



Gross  
Receipts  
70%

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## **Personal Property Tax Relief**

- Commercial personal property exempt from 12 of 24 education mills (average 23 percent cut).
- Industrial property exempt from 24 education mills and firms receive 35 percent refundable credit for remaining industrial personal property tax.
- Provides a personal property tax cut of 65 percent on average for industrial property.
- Schools protected by dedicating a portion of the MBT to the School Aid Fund.

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## **Special Provisions for Small Businesses**

- Firms with less than \$350,000 in gross receipts exempt.
- Full tax liability phased-in for \$350,000 to \$700,000 in gross receipts through a credit.
- Allow qualifying firms to pay 1.8% on adjusted business income.
- Raised alternate tax officer compensation disqualifier from \$115,00 to \$180,000.
- Double gross receipts disqualifier from \$10 million to \$20 million.

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## Credits Provide Incentives to Do Business in Michigan

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- **Compensation credit** – for 0.37 percent of Michigan compensation.
- **Investment tax credit** -- for 2.9 percent of Michigan investment.
- **R&D Credit** – for 1.9 percent of Michigan research and development expenses.
- Sum of compensation and investment credit cannot exceed 52 percent of MBT liability;
- Sum of all 3 credits cannot exceed 65 percent of liability.
- Credit provisions reduced for 2008.

## MBT Surcharge

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- PA 145 of 2007 repealed service tax and replaced revenue with an MBT surcharge.
- Surcharge is 21.99% of tax before credits.
- Major credits are lowered.
- Due to timing, changes were an approximately \$100 million tax cut in FY 08, revenue neutral with respect to replacing service tax thereafter.
- For financial institutions, surcharge is 27.7% for 2008 and 23.4% thereafter.
- Small business credit can completely eliminate surcharge.

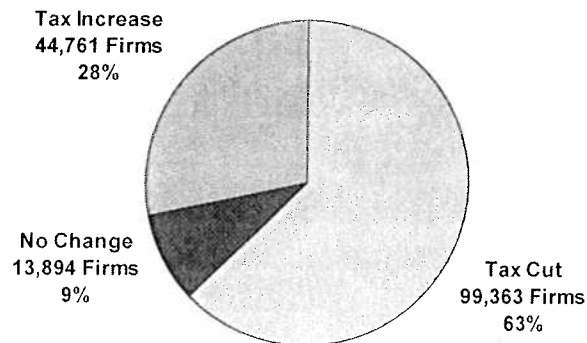
## MBT Changes to Credit Provisions

In addition to the 21.99% surcharge, the following changes were made to the MBT credit provisions

MBT Provision	Original	After PA 145	
		2008	2009
Compensation Credit	0.370%	0.296%	0.370%
Investment Tax Credit	0.290%	0.232%	0.290%
Research & Dev. Credit	1.900%	1.520%	1.900%
Max of Comp and ITC Credits	65.0%	50.0%	52.0%
Max of Comp, ITC, R&D Credits	75.0%	65.0%	65.0%

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## Two Out Of Three Taxpayers Pay The Same Or Less Under The MBT



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Note: Estimates based on TY 2009 law using 2003 SBT data.

## **P.A. 433 and P.A.434**

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- **Gross receipts exclusions and definitions**

- Taxes in the base
- Foreign dividends and royalties
- Receipts of related entity
- Treasury function definitions
- Personal investment income

- **Federal decoupling**

- Bonus depreciation

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## **Constitutional and Other Constraints**

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## U. S. Constitution and Federal Law

- Equal protection clause requires rational basis for different classes.
- Due process clause requires relationship between tax and connection to state.
- **Commerce clause regulation reserved for Congress; affects instate preferences and ability to subject firms to state taxing power (nexus).**
- PL 86-272 controls who states may be subject to income tax.

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## Sales and Income Tax

- **Sales and Use tax**
  - 6% rate cap; likely bars local sales taxes if fully used.
  - 73% for schools, 10% for local government.
  - Food not for immediate consumption and prescription drugs exempt.
- **Income tax**
  - No graduation as to rate or base.

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## Property Tax Rates

- 15 mills may be levied and allocated in the county without voter approval.
- Limits may be increased to 18 by voters.
- Separate tax limits in each jurisdiction may be increased to 50 by voters (charter units and authorities excluded from limit).
- Maximum authorized millage must be rolled back if existing property increases by more than inflation.

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## Property Tax Rates

- No increase in local government maximum authorized rate without voter approval.
- Bonds pledging unlimited taxing power require voter approval.
- No increase in school maximum authorized operating millage without  $\frac{3}{4}$  legislative vote.
- Rates must be uniform on all classes of property within taxing unit; schools may have non-uniform rates.

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## **Property Tax Assessments**

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- All classes of property must be assessed at uniform percentage of true cash value.
- Taxable value cap provides practical exception limiting increases to rate of inflation, excluding new construction, until transfer of ownership.

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## **Comparative Tax Burdens**

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## State Tax Burden Rankings

- Michigan's tax burden is near the national average.
- Michigan tends to have higher state taxes and lower local taxes than many states because Michigan raises a higher proportion of K-12 school revenue at the state level than many states.
- Michigan's overall business tax burden is close to national average.

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## Michigan Total State and Local Tax Burden Close to Average

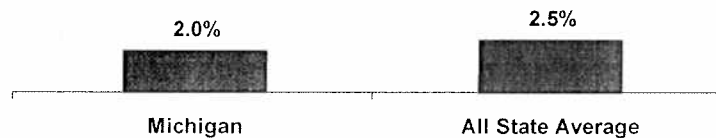
State & Local Tax as		
<u>State</u>	<u>% of Pers. Income</u>	<u>Rank</u>
Wyoming	15.8%	1
Wisconsin	11.9%	11
Ohio	11.6%	15
Indiana	11.6%	16
Minnesota	11.5%	18
U.S. Average	11.2%	
<b>Michigan</b>	<b>10.9%</b>	<b>26</b>
Illinois	10.9%	27
New Hampshire	9.0%	50

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Source: Census data for FY 2006 and Michigan Department of Treasury Calculations adjusting for MBT surcharge and IIT rate increase.

## Michigan Ranks 37<sup>th</sup> Highest in State and Local *Income* Taxes

2006 Total State and Local Income Taxes  
as a % of Personal Income

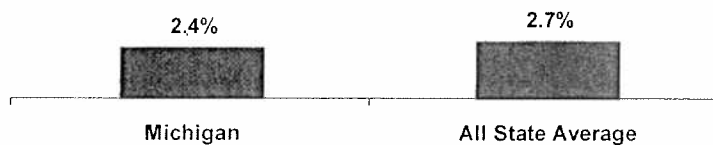


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Source: Census data for FY 2006. Michigan adjusted to include income tax rate increase.

## Michigan Ranks 31<sup>st</sup> Highest in State and Local *Sales* Taxes

2006 Total State and Local Sales Taxes  
as a % of Personal Income

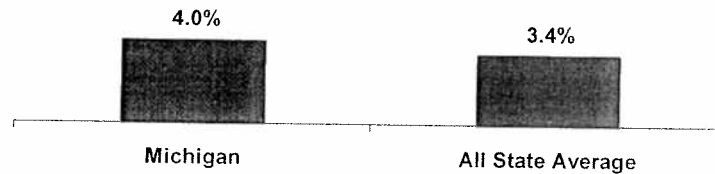


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Source: Census data for FY 2006 -adjusted for 2007 tax changes

## Michigan Ranks 13<sup>th</sup> Highest in State and Local *Property* Taxes

2006 Total State and Local Property Taxes  
as a % of Personal Income



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Source: Census data for FY 2006.

## Addendum- Unreserved Fund Balances

<u>Fiscal Year</u>	<u>General Fund</u>	<u>Budget Stabilization</u>	<u>School Aid Fund</u>	<u>SAF Budget Stabilization</u>
1999	\$0	\$1,222,483,000	\$572,849,000	\$0
2000	\$211,810,000	\$1,264,434,000	\$853,420,000	\$0
2001	\$28,072,000	\$994,187,000	\$694,796,000	\$0
2002	\$114,500,000	\$145,150,000	\$237,010,000	\$0
2003	\$173,956,000	\$0	\$113,668,000	\$0
2004	\$0	\$81,258,000	\$0	\$72,400,000
2005	\$220,537,000	\$1,953,000	\$0	\$93,700,000
2006	\$2,482,000	\$2,017,000	\$0	\$0
2007	\$259,080,000	\$2,090,000	\$0	\$82,351,000
2008	\$457,870,000	\$2,156,000	\$0	\$247,100,000

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Source: State Budget Office